First, the Commission already has concluded that a business/residence market segmentation is appropriate when making a competitive analysis in the *UNE Remand Order*.[45] Thus, the Commission already has made this distinction in other contexts and should do so here.

Second, adding such factors to the Phase II trigger analysis would reflect the fact, based on market experience to date, that competitors entering new markets primarily target business customers. The different market realities also are indicated by the additional service options available to business customers. Since the number of "business locations" may be a relatively small percentage of total "customer locations" in an MSA, it is possible that a price cap ILEC could lose most, if not all, of its total business market before obtaining Phase II relief by showing that 50% of its "total customers" were able to obtain competitive services. Such a loss would be inefficient if the ILEC were, in fact, the low cost producer, and the customer attrition was due to rivals' ability to undercut the ILEC's prices – which have been set at uneconomic levels pursuant to Part 69.

Third, CLECs should not be able to hamstring a competitor by manipulating the type of customers for which they compete. Indeed, the FCC already has held that Phase II deregulatory relief should not be contingent upon such gamesmanship.[46]

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45 *FCC Reforms High-Cost Support to Ensure the Preservation and Advancement of Universal Service*, FCC Press Release, CC Docket No. 96-45, Oct. 21, 1999.

46 *Fifth Report and Order*, at ¶ 143.

Therefore, it is entirely appropriate that the trigger for Phase II relief should avoid the risk that CLEC deployment decisions could artificially delay the competitive deregulation of the ILEC common line services. For these reasons, ILECs should be able to make a pricing flexibility showing based on classes of consumers.

Furthermore, to be consistent with the transport criteria established in the *Fifth Report and Order*, GTE suggests that the Commission approve in this proceeding an alternative showing that would allow the price cap ILEC to demonstrate that competitors, in aggregate, offer service to customer locations that represent at least 65 percent of the price cap ILEC's common line subscriber line charge ("SLC") revenue in the MSA/RSA.[47] This alternative is critical for the same reasons it was adopted by the Commission in its consideration of transport services: the concentration of SLC revenue in certain areas, and for certain classes of customers, is extremely high.

Therefore, in some MSAs a price cap ILEC may earn a very high percentage of its SLC revenue in areas where competitive offers are available despite the fact that fewer than 50% of its total customer locations are actually in these areas. In such cases, the ILEC should be granted Phase II relief since, as the Commission has recognized, "competitors are drawn to new markets by the prospect of earning revenues, rather than merely opportunities to provide capacity [or service to

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47 *Id.* at ¶ 106.

locations]."[48] Finally, this measure takes into account the FCC's own determination that "revenue is a more relevant measure of market entry."[49]

There is no justification for establishing a more stringent trigger for common line and switching services than the percentages selected for transport and special access. Facilities-based alternatives to the loop – both wireless and broadband – exist today and rapidly are becoming widely available. For common lines, wireless customers now can access voice services easily and reliably throughout the country. Many customers use wireless as an alternative to wired loop services, and AT&T has even promoted the use of wireless as "your only telephone." Although the FCC excluded mobile customers for the purpose of establishing Phase I triggers, this exclusion is arbitrary and fails to take into account a significant competitive force that constrains the ability of an ILEC to raise prices above market levels. In addition, AT&T is in the process of amassing a huge number of broadband wire loops into the home to provide voice and other services. These alternative "last mile" facilities show the ease with which facilities-based competition is coming to the marketplace.

With respect to switching, the Commission already has acknowledged that competitors can easily deploy their own switches in the market. Indeed, the Commission specifically determined as much when it concluded that "incumbent LECs need not provide access to unbundled local switching for business customers with four

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48 *Fifth Report and Order*, at ¶ 87.

49 *Id.*

or more lines that are located in the densest parts of the top 50 Metropolitan Statistical Areas (MSAs)."[50] Based on the above, there is no reason to create higher triggers for Phase II deregulation of common line and traffic sensitive services.

C. No Special Protection Measures Are Necessary Once The Phase II Triggers Are Met.

The Commission seeks comment on whether it should adopt certain safeguards for Phase II relief for common line and traffic-sensitive services that have not been imposed with respect to dedicated transport and special access services.[51] GTE believes that, just as the Commission determined with regard to dedicated transport and special access services, there is no need for such safeguards. Once the triggers for Phase II relief have been met and competition exists in the market for common line and traffic-sensitive services, the market will serve as the best mechanism for controlling pricing.

IV. THE FCC SHOULD NOT MANDATE THAT CARRIERS IMPOSE A FLAT-RATE CHARGE FOR EITHER LOCAL OR TANDEM SWITCHING.

The Commission requests comment on replacing the existing per-minute/per-call rate structure for both local switching and tandem switching with a structure based on

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50 *FCC Promotes Local Telecommunications Competition - Adopts Rules on Unbundling of Network Elements*, Report No. CC 99-41 (Sept. 15, 1999). GTE already has supplied the Commission with further evidence of the availability of switching alternatives in the Marketplace. *See* Comments of GTE, UNE Remand Proceeding, p. 32, 39-48.

51 *FNPRM*, at ¶ 205.

capacity.[52] GTE believes that mandating such dramatic shifts in rate structure in today's environment is unnecessary and a waste of resources. The Commission should move swiftly to deregulate these prices by removing them from the scope of Part 69, not add yet another layer of mandates to the Rules. The Commission does not have the information or resources necessary to optimize a new, mandated rate structure. Nor has it considered what would be required to implement such a structure. Additionally, the proposal could complicate other Commission initiatives, such as those involving low volume interexchange consumers.

Thus, rather than mandate specific changes, the Commission should instead follow the trend set in the *Fifth Report and Order* to give carriers additional pricing flexibility, including the ability to use capacity-based pricing where the ILEC finds it is appropriate. By following this course, the Commission will avoid creating regulations that "unduly interfere with the operation of these markets as competition develops."[53]

A. Given The Commission's Goal To Deregulate Access Services, Revising Part 69 Rate Structure Rules Is A Waste Of Resources.

Since enactment of the Telecommunications Act of 1996, the Commission has charted a course intended to give carriers increasing flexibility to set access rates "until competition gradually *replaces* regulation as the primary means of setting prices."[54]

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52 *Id.* at ¶¶ 207 & 223.

53 *FNPRM*, at ¶ 1.

54 *Id.* at ¶ 2 (emphasis added).

The goal of each subsequent proceeding has been to devise rules that will "give carriers progressively greater *flexibility* to set rates as competition develops."[55]

Consequently, GTE is quite surprised to see, at this late stage, a proposal to change the access charge structure to incorporate capacity pricing and flat rate charges that simply does not further the ultimate goal of *eliminating* the rules governing access charges. Not only are these proposals inconsistent with the Commission's deregulatory mandate, but also introduce very complex issues that will be difficult to resolve. Addressing these issues will require substantial expenditure of industry and Commission resources, all in the name of revising a structure destined for elimination as the market becomes competitive in the near future. This misuse of resources would not serve the public interest.

B. Static Rules Cannot Account for All of the Variables Inherent in Capacity Pricing and Could Lead to Unintended Consequences.

The suggestion in the *FNPRM* to replace per-minute with capacity-based charges for local and tandem switching is a step in the wrong direction because it attempts to impose a particular pricing regime, rather than giving carriers the flexibility to price their services in response to customer needs. From the beginning, one of the chief difficulties with the Commission's access charge rules was that they attempted to prescribe specific rate elements for switched services. The Commission itself

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[55] *Id.* at ¶ 2 (emphasis added).

recognized that this rigid structure limited the industry's ability to react to changes in technology, differences in geography and customers' needs, and to the development of competition.[56] In recent years, the Commission took steps to reform this approach and allowed carriers to develop their own rate structures. This process continues in the present *Order* and *FNPRM*, which would allow carriers to introduce new rate elements without a public interest showing, and which establishes procedures for removing services from price caps and from the requirements of the Commission's Part 69 rules prescribing rate structures.

Rather than mandate changes, if the Commission believes that capacity-based charges for local switching has merit, it should relax its current requirement in Part 69 that carriers charge for local switching on a per-minute-of-use basis. Carriers should have the flexibility to charge capacity-based switching prices if cost and market conditions so warrant. Requiring them to do so would be counterproductive. At this point in the development of access markets, it is not reasonable for the FCC to attempt to devise a new pricing structure and impose it on the exchange carrier industry.

As the *FNPRM* notes, the Commission has examined the issue of peak and off-peak rates for local switching before. The Commission rejected any requirement for peak/off-peak pricing for a number of reasons, including the difficulty of determining the peak hour in different switches and for different user types, as well as a concern over

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[56] *See, e.g., The NYNEX Telephone Companies Petition for Waiver Transition Plan to Preserve Universal Service in a Competitive Environment*, 10 FCC Rcd 7445 (1995).

shifting peaks.[57] In the present *FNPRM*, the Commission suggests that capacity-based prices might serve as a sort of "magic wand" which would obviate these difficulties. In fact, capacity-based pricing shares many of the same theoretical advantages and practical difficulties of peak/off-peak pricing.

As an initial matter, the *FNPRM* does not actually propose a true capacity-based charge for switching. Instead, it suggests a charge for interoffice *trunk* capacity as a surrogate for local *switching* capacity. The *FNPRM* wrongly assumes that an increase in the number of trunks for interstate switched access would be associated with an increase in the peak usage for which switch capacity must be provided. In reality, interstate switched access is but one category of usage that affects the demand for switch capacity. Other categories of use include: local, intraLATA toll, intrastate access, and Internet traffic. The traffic-sensitive components of the switch are shared resources which must be engineered to accommodate the peak level of the sum of all these demands.[58] Yet, the *FNPRM* implicitly assumes that a charge for capacity on

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57 *FNPRM*, at ¶ 211.

58 Because traffic-sensitive switching capacity is shared among different customers and different types of traffic, it is not sold to each customer on a dedicated basis, as loops and dedicated trunks are. Thus, the "capacity-based" charge proposed in the *FNPRM* would not assign a dedicated unit of switching capacity to the customer who pays such a charge. The Commission has long recognized that fixed, customer-specific costs should be recovered through flat charges, while shared, traffic-sensitive costs should be recovered on a traffic-sensitive basis. Local switching charges should apportion traffic-sensitive costs among customers whose combined demand causes those costs. The *FNPRM*'s proposal does not represent a move away from usage-based pricing, but rather employs a different unit – trunks – as a measure of the relative demand each customer places on the switch. If traffic peaks are not coincident, it is not
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interstate trunks represents a charge for peak capacity of the switch, but that is only the case if the peak hour on a given interstate trunk group is coincident with the peak busy hour of the switch. As the Commission is aware, the public switched network comprises thousands of local switches, each of which faces a different combination of local, Internet, intrastate, and interstate demands. It is unreasonable to assume, as the Commission's theory apparently does, that the interstate access traffic each IXC sends to each switch peaks at the same time as the switch does.[59]

This assumption is critical to the public interest benefits the Commission seeks to acquire. If these peaks are not coincident, then a "capacity-based charge" related to interstate trunk capacity would not "reflect the manner in which incumbent LECs incur local switching costs better than the existing rate structure," as the *FNPRM* speculates.[60] Yet, under the Commission's scheme, each IXC has an incentive to move traffic away from its peak times. This scheme ignores the fact that, even if the interstate traffic of a given IXC peaks at a different hour, that IXC nevertheless has an incentive to move traffic from its peak hour to the peak busy hour of the switch. This could result in

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clear that trunks provide a better means of assigning traffic-sensitive costs than minutes do.

59 It is common practice for an IXC to segregate its switched access traffic onto different trunk groups by type of traffic (originating, terminating, operator, 800). It would be surprising if all of these groups peaked at the same hour. As the *FNPRM* notes (at ¶ 211) one of the complexities of peak/off peak pricing is that traffic peaks differ by type of customer. The proposed capacity-based charge does not escape this difficulty.

60 *FNPRM*, at ¶ 211.

even higher demands on the switch, not lower, and would hardly "encourage more efficient use of the public switched network," as the *FNPRM* suggests.[61]

Even if the Commission's assumption were correct, and the proposed capacity-based charge per trunk did in fact represent a form of peak-load pricing for switching, it is still not clear that efficiency would be improved in the manner the *FNPRM* expects. In order for the new structure to affect customer behavior, it must first be reflected in the end-user prices customers pay for long distance service. The *FNPRM* speculates that IXCs would, in fact, develop off-peak pricing plans, that this would encourage more efficient use of the network, and that residence customers in particular would benefit.[62] This chain of reasoning ignores the fact that each major IXC has thousands of trunk groups that peak at different times. In order for the benefit to develop, the IXC would somehow have to reflect these characteristics in prices that are averaged nationwide, that are presented in service packages, and that are targeted to specific segments of the market. In short, IXCs would face the same difficulties of peak/off-peak pricing the Commission has identified for ILECs, related to "geographic, user-type, and service considerations."[63] Further, the trend in recent years has been for IXCs to offer simplified, "one price" plans which have less, rather than more, differentiation of prices

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61 *Id.* at ¶ 212.

62 *Id.* at ¶ 212.

63 *FNPRM* at ¶ 211.

by time of day.[64] It appears unlikely that the adoption of the proposed structure for local switching would reverse this industry trend. Finally, even if the IXCs could implement prices which would affect consumers' behavior, they would have the same risk of shifting the peak hour, as noted in the *FNPRM*.[65]

In sum, the proposed capacity-based charge holds some theoretical promise, but the supposed benefits are unlikely to be achieved in practice. The proposal will act as a substitute for peak/off-peak pricing only if certain unstated assumptions about traffic patterns are true – which is unlikely to be the case. Even if these necessary conditions are met, the same basic difficulties which surround peak/off-peak pricing, and which have led the Commission to reject such pricing in the past, will also apply to capacity-based pricing.[66] The Commission simply cannot improve by fiat the efficiency of access markets by imposing a new, mandatory rate structure. The solution to the current, rigid

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64 IXCs have also initiated minimum flat monthly charges. To the extent that new capacity based charges for access lead to increases in flat monthly charges by IXCs, they could exacerbate the concerns the Commission has recently identified over possible effects on low-volume interexchange customers. *See* Low-Volume Long-Distance Users, CC Docket No. 99-249, *Notice of Inquiry*, FCC 99-168 (rel. July 20, 1999).

65 *See FNPRM*, at ¶ 211 ("In addition, charging different prices for calls made during different times of day may cause customers to shift their calling to less expensive times, thereby resulting in different peak times.").

66 The Commission found that practical difficulties made it "impossible to establish and enforce a rational, efficient, and fair peak-rate structure." *Access Reform First Report and Order*, at 16046.

structure is not a newer rigid structure, but rather greater flexibility for each carrier to develop new pricing approaches in light of market experience.[67]

C. Flexibility, Not Mandatory Requirements, Will Serve To Develop and To Protect Market Participants.

The Commission also seeks comment on whether permitting volume and term discounts for switched access services will negatively impact small IXCs and the development of a resale market in those services.[68] GTE believes that there are no valid reasons to establish rules to protect a particular class of access customers. Indeed, such favoritism violates cost-causation principles and undermines competition.

In fact, GTE is surprised that the FCC is raising this issue given that the agency has abandoned in other contexts an approach that tailors its rules to provide special treatment for individual types of access customers. For instance, the MFJ court originally imposed an "equal charge, per unit of traffic" rule for transport pricing in order

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[67] To this end, GTE believes that the CALLS proposal will obviate the need to focus on restructuring switching charges. This proposal would dramatically reduce the level of interstate local switching charges, without the need for a new rate structure mandate. At the end of the CALLS transition, GTE's average local switching rate would be on the order of one quarter of a cent per minute. This would certainly address any possible concerns over the level of local switching rates. Further, with switching rates at such a low level, the effect of any difference in rate structure would be minimized, and the potential benefits of any new structure would be reduced, compared to the costs of implementing such a structure. Thus, the Commission should promptly adopt the CALLS proposal, and should then leave any further refinement in the structure of local switching charges to the carriers themselves.

[68] *See FNPRM*, at ¶ 216.

to ensure that small IXCs would not be disadvantaged vis à vis AT&T.[69] Although this rule was set for termination in 1991, the FCC continued the special transport pricing, for a time, and largely phased it out in a series of steps. It did so irrespective of the potential impact such a change could have had on smaller IXCs.[70] In addition, the FCC had permitted ILECs to establish zone pricing and volume and term discounts for some types of transport so that ILECs could price more closely aligned with costs.[71] The FCC should continue to rely on the sound economic theory represented by these decisions: if pricing is justified by efficient economics, the FCC should follow that model and not carve out specific exceptions for specific players in the market.

In fact, not all market responses will necessarily disadvantage small IXCs. For example, GTE has designed a discount plan for switched services called "Zone Plus" to avoid that result.[72] This proposed plan provides volume discounts on the basis of *end-user* volume. Given this focus, no IXC, large or small, is necessarily disadvantaged.

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69 *U.S. v. AT&T*, 552 F. Supp. 131, 233-34 (1982), *aff'd sub nom., Maryland v. U.S.*, 460 U.S. 1001 (1983).

70 The FCC began dismantling the rule by allowing flat-rated charges for direct-trunked transport in *Transport Rate Structure and Pricing*, 7 FCC Rcd 7006, 7016-17 (1992). The FCC eliminated the "unitary" rate structure for tandem-routed traffic and adopted a phased-in approach that established more cost-based transport pricing. *Access Charge Reform*, 12 FCC Rcd 15982, 16053-55, ¶¶ 165-69 (rel. May 16, 1997).

71 *Expanded Interconnection with Local Telephone Company Facilities Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, (Transport Phase I)*, 8 FCC Rcd 7374, 7423-24 (rel. Sept. 2, 1993).

72 Petition for Waiver of the GTE Telephone Operating Companies (filed November 27 1995). While GTE has developed this innovative pricing scheme in

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In short, it makes little sense for the Commission to take steps to promote competition and cost-based pricing but then undermine these goals by seeking to protect individual competitors within that same market. It is clear, and experience has shown that, as this market continues to develop, the natural forces of competition will serve to regulate and mitigate any competitive concerns with respect to volume and term differentials and the impact on small IXCs. As is the case already in the market for interexchange telecommunications services, mechanisms will develop to allow those companies to remain competitive with larger companies.

However, any solution that involves particular pricing for specific segments of the market is incorrect. If ILECs are required to retain existing per-minute/per-call switching charges for one segment of the access market concurrently with non-traffic-sensitive charges, arbitrage situations will certainly occur. If such arbitrage is available, the market will generate inefficient outcomes. For instance, if small IXCs receive beneficial pricing, then even the largest IXCs would have an incentive to create small, qualifying subsidiaries to take advantage of the arbitrage opportunity, regardless of the general market need to do so. The Commission should, therefore, not adopt any special rules designed to protect small IXCs, per se.

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response to market conditions, the FCC never acted on the waiver.

D. The Commission Should Not Mandate Capacity-Based Pricing, But Rather Give Carriers the Flexibility To Implement It as the Market Warrants.

In short, rather than mandate capacity-based pricing with an accompanying set of complex rules, the Commission should simply give carriers the flexibility to modify rate structures as cost-causation or market factors dictate. Under this approach, if a carrier finds that setting prices on the basis of a flat, per-trunk charge makes competitive and economic sense, that carrier would have the flexibility to make such a move in response to competitive incentives. By acting in this manner, the Commission will be continuing down the path first charted out in the *Access Reform First R&O* and continued in the *Access Reform Fifth R&O* "to grant greater flexibility to price cap LECs as competition develops."[73]

V. THE FCC SHOULD FOCUS ON DEREGULATING PRICE CAP CARRIERS, NOT ON TINKERING WITH MISCELLANEOUS ASPECTS OF THE ANTIQUATED PRICE CAP REGIME THAT HAS LOST ITS USEFULNESS.

A. The FCC's Rules Already Rapidly Eliminate The CCL Charge, Thereby Obviating The Need To Adopt New Requirements For That Rate Element.

The FCC invites comment on whether the "g" factor in the common line price cap index formula should be increased, and if so, whether it should be increased to a full "g."[74] This inquiry stems from a concern that CCL charges have not been fully

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[73] *FNPRM*, at ¶ 3.

[74] *Id.* at ¶ 227.

eliminated and a perception that interexchange carriers make a greater contribution than ILECs to demand growth.[75]

GTE submits that the "g" factor should never have been adopted in the first instance. The X-Factor formula has already adjusted for the phenomenon, because, as Dr. Taylor explains in his report attached to the comments filed concurrently by the USTA,[76] the X-Factor already accounts for the demand changes that were intended to be corrected by the "g" factor.[77] To adjust the X-Factor as proposed would improperly double-capture demand changes.[78]

Even were this not the case, adjusting the X-Factor would be unnecessary. The CCL charge has already been eliminated for many large ILECs and will eventually be eliminated for all price-cap carriers. In addition, the CALLS proposal also paves the way for quick elimination of the CCL charge for all, participating carriers, thereby eliminating the problem. Given that the CCL will shortly be eliminated, it is not appropriate for the FCC to tinker further with the growth factor that was not needed in the first instance. Eliminating the CCL is a far simpler, cost-based, and therefore

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[75] *Id.* at ¶ 226.

[76] Comments of William E. Taylor, Ph.D., on behalf of USTA, CC Docket No. 96-262 (filed Oct. 29, 1999).

[77] *Id.* at 5.

[78] Given this fact, who was responsible for generating greater minutes, IXCs or ILECs, is irrelevant.

preferable, solution to the perceived problem than the additional regulation inherent in adjusting the price cap formula.

B. Because No Mandatory Restructuring Is Warranted, the FCC Should Discard the Proposed "Q" Factor Proposal and Any Retroactive Adjustment.

The Commission makes the tentative conclusion that any capacity-based pricing structure would need to include a "q" factor, similar to the "g" factor in the common line PCI formula, in order to incorporate growth into the pricing structure.[79] GTE believes that no such factor is needed. GTE supports the conclusions reached by Dr. Taylor in his analysis attached to the comments in this proceeding by USTA.[80]

First, as a general matter, the Commission should not attempt to adjust for the growth of any particular service – such as local switching – through an adjustment factor, such as the proposed "q". Since 1997, the Commission has selected its X-Factor using a direct measure of total factor productivity ("TFP"). This approach measures the growth in all inputs, relative to the growth in all outputs. Thus, the measure used to develop X has already taken into account the actual growth in output – including the growth in local switching minutes – in the past. No further adjustment for the growth in any given output is needed, or appropriate. Because TFP is measured on a total company basis, and cannot usefully be disaggregated to specific services, it

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[79] *FNPRM*, at ¶¶ 207 & 225.

[80] The Taylor study includes an examination of the following areas: Revision of Traffic Sensitive PCI Formula, Adjustment to Traffic-Sensitive PCIs, the "G" Factor, and (Continued...)

is not reasonable for the Commission to attempt to "assign" the presumed benefits of growth to any given service. Further, if some different unit of output had been used for access pricing purposes, then the measure of output used for TFP measurement purposes would have changed accordingly, and the appropriate X-Factor for the period since 1997 would have been different. The same would be true for any prospective X, if the Commission were now to order a change in demand units going forward. In neither case is any further adjustment for demand growth needed to prevent a "windfall."

Prior to 1997, the Commission based its X-Factor determinations on an indirect measure of productivity. This approach sought to determine the X-Factor that would be necessary to provide a normal rate of return, given the actual growth in revenue. Thus, this approach also fully accounted for the effects of growth in output, and was explicitly designed to prevent any "windfall" in earnings as a result of growth. No additional adjustment for the growth of any particular output is necessary to ensure this result.

Second, the *FNPRM* suggests that some adjustment is necessary because an increase in trunk demand may cause a measurable increase in local switching costs only when the increase in peak demand requires an expansion of switch capacity. Thus, the *FNPRM* suggests, "local switching costs may not vary directly with changes in

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Reflection of Revised Common Line Rate Structure in Common Line Formula.

per-trunk demand."[81] None of this provides a logical basis for adjusting price caps. It is generally the case that telecommunications investment is "lumpy" – it comes in discrete units or steps. Until it is time to install the next "lump," additional demand can be accommodated without additional investment. However, it would be unreasonable for telecommunications firms to price on the basis of this theoretical, low short-run cost; this is why telecommunications prices are based instead on long-run costs, which "smooth over" the short-run variations caused by lumpy investment. There is no more reason to adjust switching prices to reflect lumpy switch investment than there is to adjust price caps for any other category – such as transport – where investment is also lumpy.

These analytical points are true regardless of whether the demand for switching is counted in the form of trunks or minutes of use. Trunks are simply another means for measuring the demand an IXC presents to a local switch. If most switched transport is carried on trunks of reasonably efficient size, and if the time-of-day distribution of demand does not change significantly, a given growth in the number of minutes should require a proportionate growth in the number of trunks.[82] Therefore, the use of trunks or

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81 *FNPRM*, at ¶ 218.

82 In general, most interoffice trunks are of sufficient size to permit efficient utilization, and, for reasons discussed above, it is unlikely that the adoption of a trunk-based measure would have any significant effect on the time-of-day pattern of usage. However, it would be reasonable to expect trunk growth to differ from minute growth during a period of transition, such as the adjustment to a newly mandated rate structure.

minutes as a unit of measurement of demand does not cause any structural problem with price caps that would require correction.

Third, the *FNPRM* suggests that some adjustment is necessary in order to correct an "imbalance" between the interests of IXC customers and LEC stockholders.[83] In fact, no such imbalance exists. As Dr. Taylor shows, switched access prices have fallen dramatically under price caps – twice as fast as the equivalent prices of LECs under rate of return regulation. [84] Price cap companies have achieved greater productivity gains, but lower earnings growth, than firms in competitive markets generally.[85] In fact, the opposite is true: since 1997, the X-Factor employed by the Commission has been higher than the X that would have been implied by the Commission's own productivity model.

The Commission's concern, therefore, may be motivated solely by the reported earnings of price cap LECs in the switching category. This is not a reasonable basis for tinkering with the price cap mechanism. The Commission adopted price caps because it believed that the price cap index would provide a more reliable means of forcing LEC prices to track trends in LEC costs than the rate-of-return mechanism the Commission had previously employed. The accounting earnings reported for a specific access category are not an accurate measure of the performance of the ILECs, or of the

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83 *FNPRM*, at ¶ 222.

84 Taylor, at ¶ 27.

85 *Id.* at ¶ 26.

effectiveness of the price cap plan in delivering benefits to consumers. Because regulatory accounting is based on lower depreciation rates than those used by comparable unregulated firms, ILEC earnings are systematically overstated.[86]

More fundamentally, for accounting purposes ILEC costs are allocated among different categories of service, and between the federal and state jurisdictions. Since there is no economic basis for these allocations, the accounting process must be largely arbitrary, and will produce anomalous results. For example, a change in demand for intrastate services will affect the accounting cost of interstate access, and hence reported interstate earnings. In past periods, interstate switched minutes grew faster than local usage, so that this "fully distributed cost" or "FDC" effect tended to draw embedded cost into the interstate jurisdiction. More recently, the growth of interstate switched access minutes has slowed, and is now only about 5% per year, well below prior levels. At the same time, the explosive growth in Internet usage has caused recorded intrastate usage to grow more rapidly. The result has been a reversal of earlier trends, and a reallocation of cost back to the state jurisdiction. As a general matter, however, the apparent earnings in a given interstate category, based on an arbitrary allocation of accounting costs, is not a reasonable basis for making policy decisions about interstate switched access.

Any attempt to adjust retroactively for presumed effects of growth in the past will double-count that growth, which has already been considered in the determination of X.

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86 *Id.* at ¶ 25.

It will also impermissibly seek to recapture results that price cap LECs have achieved in response to the incentives established under the price cap plan. This, together with any prospective application of "q" will prevent the Commission from establishing a credible commitment to the price cap regime in the future. For all these reasons, the Commission should not adopt a "q" factor adjustment, regardless of whether or not it imposes a capacity-based structure for local switching.

C. Rather than Wholesale Reorganization of Baskets, the FCC Should Streamline the Baskets in Line with USTA's Proposals.

Because of a concern regarding the potential for cross-subsidization by LECs between flat-rated trunk ports and traffic-sensitive services, the Commission has proposed changes to the baskets in which these services are placed. Specifically, the *FNPRM* invites comment on proposals to modify its price cap rules to place flat charges and traffic-sensitive charges in separate baskets. These changes purportedly are motivated by an unfounded fear that LECs otherwise could eliminate their existing flat trunk port charges, and thereby circumvent the local switching rate structure rules adopted in the *Access Reform First Report and Order*.[87]

GTE does not support this wholesale realignment of the existing basket structure and believes that the proposal to reorganize this system is inconsistent with price cap theory and will simply result in increased costs for price cap LECs while providing no benefit to consumers. Instead, GTE suggests that the Commission need only

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[87] *FNPRM*, at ¶ 234.

streamline the current basket and band structure along the lines of USTA's proposals.

First, the FCC's stated reason for realigning the price cap baskets – to place flat-rated elements and traffic-sensitive elements in separate baskets – is inconsistent with the original rationale for separating access prices between different baskets. When price caps were originally established, the FCC stated that it wanted to establish separate baskets to reflect the functional separation of elements contemplated by the Part 69 structure as well as to minimize the ability of LECs to disadvantage one class of customers vis à vis another, such as where there could be cross subsidy between services subject to little competition and those subject to relatively greater competition or to protect universal service.[88] When the Commission has restructured services among baskets and bands, it has done so based on these original rationales.[89] Realigning services in baskets or bands based on whether the charges are flat-rated or minute-of-use based has no relationship to either of the rationales used by the Commission to date to realign baskets. The rate structure, per line or per minute, is unrelated either to placing similar services in the same baskets and bands or to

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[88] *See generally Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, ¶¶ 209-15 (1990).

[89] For instance, when the Commission established a separate charge for direct-trunked and tandem-switched transport, it required separate service categories so that one class of customers would not be disadvantaged over another. *Transport Rate Structure & Pricing*, 7 FCC Rcd 7006, 7043 (1992). The FCC basket and band restructuring associated with tandem-switched transport was justified by placing similar services in the same basket. *Transport Rate Structure & Pricing*, 9 FCC Rcd 615, 622-23 (1994).

ensuring that one class of customers is not disadvantaged vis à vis another. The Commission has enunciated no reason why it would suddenly abandon the original rationales for the basket and band structuring and GTE can discern no legitimate basis for doing so. The Administrative Procedures Act prohibits such arbitrary shifts in policy without adequately stating the reasons for a change.[90]

Second, the administrative expense associated with an overhaul of the baskets, related primarily to the efforts required to recompute and implement a new scheme of annual filings, will be significant. In contrast, streamlining the baskets, such as eliminating service band constraints, as proposed by USTA would entail very little expense and could improve the efficiencies to be achieved during the remaining time that price caps will be in effect. Further, there is no reason to believe that the incentives that result from basket restructuring will provide any marginal price benefits for customers. This is especially true given the length of time needed to implement a change and the likelihood that such changes would be in effect in some areas for only a short period of time before the elimination of price cap regulation in Phase II. Consequently, there is no justification for segregating flat-rate and traffic sensitive charges in individual baskets. Rather than realigning elements between baskets, the Commission should delete certain bands or baskets in their entirety.

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90 *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 851 (D.C. Cir. 1970).

D. There Is No Need To Adjust the Price Cap Formula for Differences in the Growth of Particular Outputs

Noting that the current rules require ILECs to charge different PICCs for different customers, the *FNPRM* asks whether different growth rates for these categories will create any windfall or shortfall for carriers,[91] and whether the formula in Section 61.46(d)(1) should be revised so that permitted common line revenues increase with the average growth rate of all common lines.[92] GTE believes that this change is unnecessary. In any event, adoption of the CALLS proposal would accomplish the change the *FNPRM* contemplates.

First, for reasons set forth above, there is no need to adjust the price cap formula for differences in the growth of any particular output. Further, as competition develops, it is not clear that growth trends observed in the past will continue. It is reasonable to expect that new carriers will target multiline customers first as they enter access markets, and that the growth of ILEC demand for multiline PICCs will be affected accordingly.[93]

Second, adoption of the CALLS proposal would obviate any concerns over different common line growth rates. The CALLS proposal would eliminate PICC charges immediately for single-line and non-primary customers, and, within a short

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91 *FNPRM*, at ¶ 228.

92 *Id.* at ¶ 233.

93 It is already the case that more than half of all new business lines added in the United States last year were provided by non-ILEC carriers.

time, for multiline customers. The proposal would gradually eliminate the current difference between the single-line and non-primary SLCs. Similarly, it would reduce, and, in most cases, eliminate, the difference between the single-line and multiline SLCs. These changes would greatly reduce the effect any differences in demand growth could have on ILEC revenue.

Finally, under the CALLS proposal, the average level of SLC charges in a given filing entity would be no higher than the average per-line level of revenue the ILEC would have been permitted to recover under price caps as of December 31, 1999.[94] Once the CCL is eliminated, this, rather than the current PCI formula, would be the constraint on the level of ILEC common line recovery. Thus, the CALLS proposal would effectively implement the suggestion in the *FNPRM* that permitted common line revenues increase only with the average growth rate of all common lines.

E. GTE Has No Objection To Adopting the New Formulation for Chain-Weighted GDPPI, as Long as It Is Implemented Only on a Going-Forward Basis.

The FCC seeks comment on its tentative conclusion that it should make the inflation measure in the PCI formula consistent with Bureau of Labor Statistics' measure and with that used in setting the X-Factor. GTE does not object to the use of the chain-weighted GDP-PI in the PCI formula, because a chain-weighted measure has been employed by the Commission elsewhere, and its use in this instance will serve to bring

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94 CALLS Proposal, § 2.1.1.2.

consistency to the calculation of the PCI. GTE's support of this proposal, however, is subject to the condition that the Commission apply the new PCI formula only on a forward-looking basis, and not use it to recalculate the index based on what the index would have been had the change been adopted for previous years. Reinitializing the PCI is inconsistent with price caps efficiency incentives and undermines legitimate business expectations.

VI. THE COMMISSION SHOULD REFRAIN FROM IMPOSING NEW REGULATIONS ON NON-DOMINANT CARRIER ACCESS CHARGES ABSENT STRONG EVIDENCE THAT SUCH REGULATION IS THE ONLY WAY TO ACCOMPLISH A CLEAR PUBLIC INTEREST GOAL.

The Commission invites comment on whether it should impose additional regulation on the rates charged by competitive local exchange carriers ("CLECs") for terminating access. GTE believes that the Commission should not do so in the absence of strong evidence that a widespread problem exists and that existing tools, such as the Section 208 complaint process and further deregulation of ILECs, are inadequate. Instead, the Commission should continue "to rely upon a marketplace solution ... to constrain CLEC access rates."[95]

The Commission has already found that CLECs do not enjoy market power in the provision of access services.[96] Instead, it determined that ILECs' access prices, or those of other potential competitors, deter CLECs from charging excessive rates.

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95 *FNPRM*, at ¶ 247.

96 *Access Charge Reform* (*First Report & Order*), 12 FCC Rcd 15982, 16140
(Continued...)

Under *Greater Boston,* an agency changing its course must take a "hard look at the issues with the use of reasons and standards" to justify its reversal of policy.[97] Given the Commission's previous determination that CLECs lack the requisite market power for dominant carrier regulation, the burden is on the proponents of regulating non-dominant CLECs to provide strong evidence for doing so. Thus far, proponents of regulating CLECs have failed to meet this burden. Anecdotal reports do not justify a leap to a regulatory response. It should be obvious that citation to a single complaint case alleging that a CLEC charged an access rate that was higher than the ILEC rate simply does not justify imposing dominant carrier regulations upon a group of carriers.[98]

Indeed, the case for continued non-dominant treatment is even stronger today than in 1997. While the growth of CLECs in this market is quite dramatic,[99] their overall market share falls well short of levels that could enable them to exercise market power. If anything, the continued growth of many CLECs, coupled with an ability to purchase

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(1997) ("*Access Reform First R&O*").

97 *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 851 (D.C. Cir. 1970).

98 *See FNPRM*, at ¶ 241 (citing *MGC Communications v. AT&T Corp.*, File No. EAD-99-002, *Memorandum Opinion & Order*, DA 99-1395 (rel. July 16, 1999)). Even in *MGC Communications*, the Bureau made no finding as to the reasonableness of the rates. At most, this case demonstrates that different carriers will charge different rates for access. Indeed, given the geographic averaging requirements applicable to ILEC rates, it should come as no surprise that CLEC rates are higher in some areas.

99 *See Teleport Communications Group, Inc., Transferor, and AT&T Corp., Transferee*, 13 FCC Rcd 15236, ¶ 27 (1998) (noting that CLECs are rapidly entering the access market).

unbundled network elements from ILECs at deaveraged and discounted rates, only serves to strengthen the market forces constraining the rates of CLECs providing access services.[100]

A superior solution would be to allow ILECs to price their competing access services flexibly in response to market signals, as suggested elsewhere in these comments. Deregulating ILEC prices would unleash the discipline of fully competitive market forces on CLEC prices.[101] GTE believes that such competitive pressures would prove far more effective than regulation in achieving the agency's goals.

Some early rough edges as the access market develops should not be unexpected. But such isolated bumps in the road do not require the draconian imposition of dominant carrier-style regulation. This is especially true given that much less intrusive regulatory tools – in particular, the Section 208 complaint process – are readily available.

In fact, the Commission has already stated in the *Access Reform First R&O* that it "will not hesitate to use our authority under section 208 to take corrective action where appropriate" in response to "indications that the terminating access rates of

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[100] 47 U.S.C. § 251(c)(3). The FCC and many states have ignored the Act's pricing standard by requiring ILEC to offer unbundled network elements at hypothetical costs that are far lower than actual costs. This confers an artificial, uneconomic advantage on new entrants that places tremendous downward pressure on access rates.

[101] *See Access Reform First R&O*, at 16140 (noting that "the rates of incumbent LECs or other potential competitors will constrain the terminating access rates of competitive LECs").

competitive LECs are unreasonable."[102] Indeed, the *MGC Communications* case cited in the *FNPRM* serves as an example of the process working, not as a reason to impose additional regulations.

Only when problems appear widespread, rather than anecdotal and isolated, should the Commission consider imposing on CLECs broader, and heavier, dominant carrier-style general regulations. Until that unlikely prospect actually occurs, the Commission should rely on its existing enforcement mechanisms to address any perceived problems.

VII. CONCLUSION

The Commission should expeditiously implement the long-postponed market-based approach to access charge reform. The CALLS proposal offers a public interest compromise that addresses many of the concerns raised by the *FNPRM*. Beyond that, the Commission should reform access charges in a deregulatory, pro-competitive manner, and refrain from actions that either impose new regulations or result in wasteful tinkering with a regulatory pricing regime that is destined to fade away in a relatively short time.

In particular, GTE urges the Commission to: (1) allow ILECs to set rates more closely aligned with costs and promote efficient competition through immediate voluntary deaveraging of common line and switching rates; and (2) apply the framework

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102 *Access Reform First R&O*, at 16141.

for Phase II relief adopted in the *Fifth Report and Order* to the Phase II deregulation of common line and switching services. The Commission should refrain from regressive, more regulatory actions such as mandating an economically unjustified capacity-based switching charge and unwarranted result-oriented "q" factor adjustment or by tinkering yet again with miscellaneous aspects of the price caps regime. Only by a consistent deregulatory focus on allowing access prices to be market-based will the Commission achieve the difficult transition to a competitive marketplace in access services.

Respectfully submitted,

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